

## Liquidity cannot be assumed to be good

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One of the arguments some have used against Robin Hood Taxes is that they reduce liquidity. A [leading critic](#) has, for example has been the Lib Dem former City trader Giles Wilkes.

Liquidity is defined as the existence of a market of such size that no one transaction can influence price.

The idea that such markets are good is based on the extraordinarily flawed logic of perfect competition inherent in standard micro-economic theory — a theory that requires assumptions to be made that mean it has no relationship of any sort with the real world. It follows in my opinion that the idea that liquidity per se is good is also, similarly flawed.

Last night Lord Turner of the UK's Financial Services Authority made a speech on the future of banking. As is his now accustomed way it was controversial. As the Guardian has noted he appeared to suggest capital controls might be of benefit — something with which I agree. He explicitly suggested the costs of some form of bank borrowing should be increased by requiring that banks hold more capital in relation to their lending to some portfolios.

But he also, and I think wisely, returned to his theme of ‘socially useless’ activity by banks — admittedly clarifying on the way that he thought ‘socially’ in this case equated with ‘economically’ [saying](#):

*There are no easy answers, but some combination of new macro-prudential tools is likely to be required." He added: "A crucial starting point is to recognise that different categories of credit perform different economic functions, and that the impact of credit restrictions on economic value added and social welfare will vary according to which category of credit is restricted.*

As the [Guardian also notes](#):

*In his lecture, he asked whether the increased trading activity in the financial sector in*

*the last 30 years had delivered economic value by reducing transaction costs and making markets more liquid. Admitting that he did not know, he said: "We certainly need to have the debate rather than accepting as given the dominant argument of the last 30 years, which has asserted that increased liquidity, supported by increased position-taking, is axiomatically beneficial."*

This requires no interpretation. He is saying that it is not clear that liquidity per se is beneficial.

Quite so.

It's time those who claim such things prove their case. Rhetorical assertion based on flawed assumptions is not proof — it is flawed rhetoric.

And so far the evidence is that market growth to sustain liquidity has benefitted no one but bankers — as I argued in [Taxing Banks](#).

These people have to engage with the argument now if they want to prove their case. And that includes an assessment of the incidence of the costs their activities impose on society, an issue of much greater importance than that of the incidence of the taxes that we propose to curtail them — which I have argued falls on banks and bankers.